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*To Our Clients:*

*The Natural Business Year has been the subject of much discussion in recent years by business men, bankers, the Stock Exchange, the Securities and Exchange Commission, associations of credit men and others whose work relates to business management and financial statements. As the leading article in the May issue of the L. R. B. & M. Journal, which is published primarily for distribution within our organization, deals with this subject, we are sending copies of this issue to our clients.*

*This issue also includes an article on the regulations issued by the Treasury for the use of the "last-in, first-out" inventory method, which is permitted by the current income tax law.*

*Lybrand, Ross Bros. & Montgomery*

L. R. B. & M. JOURNAL

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# How Businesses Profit from the Adoption of a Natural Business Year

BY JOHN W. CONRAD

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The question is frequently asked of accountants, "What would be gained from the adoption of a natural business year?" or "Could we benefit from a tax standpoint by closing our books at a date other than December 31st?" This article is an attempt to answer these questions and, from observations made and conclusions drawn from actual experience, to direct attention to some of the possible tax and other advantages to be realized from the adoption of the natural business year.

"The natural business year of an enterprise is the period of twelve consecutive months which ends when the business activities of the enterprise have reached the lowest point in their annual cycle."* Simply stated, it is the period of twelve months which ends with the close of the natural operating season of a business. At such a time annual sales and production activities have normally subsided and a balance sheet reflecting the financial position of the business will display its most liquid condition. If for no other reason, this is important from the standpoint of the banker or credit agency. A business is thus able to make its best showing in establishing a maximum line of bank credit or in seeking a favorable credit rating.

Recent studies made by several trade organizations have brought to light the interesting fact that almost every business enterprise has a natural cycle of operations beginning and ending at the same date each twelve months. Some few businesses have two such cycles within a twelve-month period. Naturally, one would not expect a business selling coal to close its books December 31st or another selling ice to adopt July 31st as the termination of its business year.

This article is primarily concerned with the immediate and concrete advantages accruing to business management from the adoption of the natural business year as the annual accounting and federal income-tax reporting period.

At this point it should be stated

*Bulletin of Natural Business Year Council.

that throughout this article the expression "fiscal year" will be used, as defined in the Revenue Acts, to denote an accounting period of twelve months ending on the last day of any month other than December.

To facilitate discussion of the subject, the matter which follows will be considered under the general headings of financial benefits, accounting advantages, personnel, federal tax advantages, and general.

## Financial Benefits

### Advantages to Business Management

Good management requires the formulation, at least annually, of policies and programs through which the activities of the ensuing year are to be directed. During a season of peak production or sales it is impossible for the busy executive to give thoughtful consideration to matters of policy affecting the coming season. Obviously, the logical time to approach these considerations is just after the close of a business cycle, i.e., at the end of the natural business year of the enterprise.

In many businesses modern merchandising policies and programs require the production each twelve months of a new model, a new style, a new design, or a new number. Moreover, in many instances these new units, which require costly new tools, jigs, fixtures, and machining methods in their production, are vastly different from other items previously in the line.

Through the use of an accounting year corresponding to the calendar year, many businesses are cutting off the closing period of one annual cycle and attaching it to the opening of the succeeding annual cycle and then attempting to compare these results with another equally unnatural and illogical period.

It is little wonder then that the conclusions reached, which form the basis of important policy decisions, are often faulty and misleading. It would be just as logical for an automobile manufacturer, who brings out a new model every year, or a theatrical enterprise, which puts on a completely new show each year, to adopt an accounting period and prepare financial statements which cover the results of operations of the last six months of one model or one show, with the first six months of another model or an entirely different show.

It is with a desire to make accounting statements more informative and to present a truer picture of the results of a complete annual cycle of operations that accountants encourage the adoption of the natural business year as the accounting period of a business. Not only do financial statements prepared for the natural business year furnish a more reliable basis of comparison, but if sufficient businesses in a particular industry should adopt the same fiscal year, helpful standard ratios and

relationships could be developed for the industry as a whole which would serve as guides for individual units of that industry.

### Formulation of Policies and Plans for Future

It is axiomatic that the experiences of a past fiscal year have an important bearing upon the determination of plans and policies to be followed during the next fiscal year. Since statements, budgets, audit reports, and future work programs should be based upon a completed cycle of operations, it follows that the statistical data developed therefrom, and the conclusions reached from a careful study of such data, are of far greater value to management than decisions based upon statements reflecting operations of an unnatural business year. Critical review and careful planning can best be done when executives are relieved, to a certain extent at least, of the usual demands upon their time. The period between operating seasons is the logical time to negotiate sales or wage contracts, consider credit needs of future months, approve expansion plans and new equipment budgets, and make other preparations for the coming season's activities.

### Bankers, Credit Agencies, Etc., Endorse the Idea

Through the widespread adoption of the natural business year, banks would be relieved of the present year-end pressure of confirming balances to public accountants. Similarly, bank credit men and the staffs of credit agencies and statistical services would be relieved of the burdensome volume of work brought about in their attempt to analyze promptly hundreds of annual reports thrust upon them within the space of a few weeks. Moreover, executives of such institutions definitely prefer statements coinciding with the natural business year, since such statements present a more complete and accurate picture of a borrower's financial position than statements based upon the conventional calendar year. Accordingly, with renewed emphasis during the past five years, bankers, credit men, accountants, various trade and management associations, stock exchange representatives, manufacturers' associations, and business management generally have given wholehearted approval and endorsement to the natural business year movement.

Among others, public recommendation of the natural business year has recently been given by the board of governors of the New York Stock Exchange and the board of directors of the National Association of Manufacturers. Each organization urged adoption of the natural business year principle. The report of the subcommittee on independent audits and audit procedure of the New York Stock Exchange as adopted by the board of governors states, among other things:

By adopting a natural business year which conforms to the true business cycle of the particular industry, corporations may simplify their problems of year-end adjustment and reduce the cost of stock taking, besides permitting a more efficient and more economical audit. The income account of a company based on a completed cycle of a normal year's operations would give the investor a fairer picture of the operations of his company. Reports of companies in the same field of business would be directly comparable, as almost all industries have their own clearly defined natural business years.

Some idea of the attitude of The Securities and Exchange Commission toward the use of the natural business year may also be gained from a recent statement prepared by William W. Werntz, its Chief Accountant, as made public in Accounting Series Release No. 17, issued by the Commission March 18, 1940. In reply to a question raised by a registrant, which was considering the desirability of changing from the calendar-year to the fiscal-year basis for its financial reports and had sought to ascertain the attitude of the Commission toward the change, Mr. Werntz stated:

> In this connection I may point out that the rules of the Commission do not prescribe the use of any particular fiscal year for the financial statements required. However, the advantages to be obtained from the adoption of a fiscal-year-end date which coincides with the lowest point in the annual cycle of operations are clear and to my mind have never been shown to be outweighed by related disadvantages. Among the more important advantages there may be mentioned the probability of obtaining more complete and reliable financial statements since at the close of the natural business year incomplete transactions, and such items as inventories, would ordinarily be at a minimum. Mention may also be made of the fact that the general adoption of the natural business year would facilitate the work of public accountants by permitting them to spread much of their work throughout the calendar year, and thus aid them in rendering the most effective service to their clients.

### Financing New Operations

Because financial statements prepared on the basis of the natural business year present a truer picture of operations and facilitate intelligent planning for the future, they are invaluable to an executive in his determination of the financial needs of the business. With such statements he can more easily estimate the extent to which he will need bank credit during succeeding months. Moreover, the financial statements furnished the banker, which form the basis of the credit line, will show the concern in its most liquid condition and reflect the results of a completed cycle of operations. There is much to be gained by the applicant for credit if the financial statements presented the banker show what the business can accomplish in attaining a maximum of liquidity by the end of the business year.

## Accounting Advantages

### Inventories

As is well known, one of the most important single steps involved in

closing a company's books at the end of a business year is the determination and valuation of the inventory. Experience has demonstrated that the margin of error in the taking and valuation of the inventory is substantially decreased when the quantities on hand are reduced. In addition, more time is available when operations are at a low ebb to determine slow-moving, unprofitable, obsolete, or surplus stocks of merchandise or materials on hand, and to evaluate properly such items at prices which will permit their ultimate disposal at not less than the values placed thereon. Also, at such a time inventories can be taken with the minimum of interference with ordinary productive operations.

While the advantages from the standpoint of personnel will be treated more in detail hereinafter, it might be mentioned at this point that certain members of the office force, relieved to some extent from the pressure of their normal duties, are generally available to assist in the taking, pricing, and extending of the annual inventory. Naturally, this obviates the necessity and expense of employing additional outside assistants who are often unfamiliar with the company's products or materials and thus likely to make more mistakes than the regular staff employees. It is an expensive undertaking to close the books, take inventory, and do all the other things incident to the termination of a business year when inventories or production are high or shipments particularly active.

Instances have come to accountants' attention where closing the books when inventories were high resulted in an actual overstatement of profits and a resultant overpayment of taxes. It is unfortunate indeed to have paid income and excess-profits taxes on profits that disappeared with the liquidation of the inventory and to find that a fictitious or inflated profit in one year was followed by a loss in the succeeding year. The natural business year basis of reporting minimizes the possibility of such overpayments of taxes.

### Accounts Receivable

In these days of strict credit requirements, it is understandable that a business should wish to present financial statements for credit purposes at a time when its financial position is most liquid. When the business activities have reached the lowest point in their annual cycle, inventories, receivables, and current payables are normally reduced to a minimum. Surely there could be no better time to ascertain the collectibility or worthlessness of receivables than when the selling season is over and the collection period nearly over. At such a time receivables are usually at a minimum both as to amounts outstanding and number of accounts; accordingly, any necessary charge-offs or required reserves may

be determined with greater accuracy and with less expenditure of time.

Another accounting and income tax advantage in compiling financial statements and filing income tax returns when receivables are low is that full allowance is taken for cash and sales discounts, and freight deductions during the period in which they belong. It is hardly necessary to point out that when the end of the accounting period divides the profits on sales from the losses or deductions on collections, an overstatement of profits and an overpayment of already burdensome taxes is likely to result. It is readily apparent that little guesswork can enter into the determination of the profit on a transaction if the calculation is made after the article has been shipped, billed, and the cash collected thereon. Thousands of taxpayers have paid taxes on one hundred percent of the amounts tied up in receivables only to find later that because of a sharp decline in business, or for some other unanticipated reason, the amounts actually collected fell considerably short of the estimated receipts.

### Accounts Payable

While on the subject of the liquidity of financial statements, another important natural business year factor which is closely related to the reduction in inventories and receivables is the liquidation of accounts payable. Normally, bank loans and amounts due trade creditors are lowest just after receivables have been converted into cash. It is apparent then that the current ratio is ordinarily higher at the end of the natural business year than at any other time, a significant fact which enhances the borrower's position with his banker.

### Preparation of Financial Statements

There has been a definite trend in recent years as the result of legislation and the activities of accounting societies, regulatory bodies, and the like, to attach greater importance to financial statements and to auditors' reports than ever before. Constant efforts are being made to improve the quality of financial statements and, by improvements in accounting technique, and more definite statements of accounting principles, to make the statements more informative, more understandable, and a more reliable presentation of the financial position of the enterprise. In furtherance of this aim it would seem essential that thoughtful consideration be given certain facts in order to ascertain if the period used in reporting the annual results of operations is a natural period for the particular business, or merely the arbitrary selection of the twelve months ending December 31st.

Financial statements, as we all know, reflect a combination of recorded facts, accounting conventions, and personal judgments; and the judgments and conventions ap-

plied affect them materially. While the soundness of the judgments necessarily depends upon the competence and integrity of those who make them, it must be admitted that financial statements, no matter how carefully or skillfully prepared, must, because of their nature, contain conclusions which cannot be measured with absolute accuracy. The larger and more complex the business, the greater the difficulty of accurately evaluating assets or measuring profits. This is true because, at a given date, the larger the business, the more transactions which will have been only partially completed. Therefore, anyone preparing financial statements must make certain allocations, the accuracy of which depends upon the soundness of the estimates and the experience and judgment of the persons making them. Naturally, the fewer the number of uncompleted operations at any financial statement date, the less the financial results will depend upon estimates. As Colonel Montgomery, former president of the Natural Business Year Council, has stated:

> Annual financial statements purport to survey historically the results of a twelve-month period of operations. Their purpose is not attained if they do not show the results of completed transactions. At any date other than the end of a natural business year, there will be many open transactions the results of which will not be definitely determinable until the end of the cycle of operations then in progress. At a date marking the end of a natural season, the majority of transactions arising during the preceding twelve months will have been completed, and their results, in terms of profit or loss, easily determinable.

It follows, therefore, that inasmuch as the item of cash on a balance sheet can be accurately determined, the greater the extent to which the receivables, inventories, etc. have been converted into cash the fewer the estimates which will have to be made and the smaller the margin of error in the financial statements.

### Annual Audits

Because of the disproportionately larger number of calendar year closings at the present time, the demand for accounting service is greatly increased during a relatively short period, and public accounting firms find it increasingly difficult to devote the necessary attention to each client, even though much overtime work is performed. After March 15, with the completion of annual reports and tax returns, the work of the public accountant declines considerably. The result of this unbalanced situation is that during the period of the year when the greatest degree of personal attention to the particular needs of each client is necessary, accounting firms find it difficult to supply such attention, and are less able, furthermore, to supplement their audit service with constructive counsel and advice.

The natural business year prin-

ciple, being intrinsically sound, needs no apologies merely because it also helps to distribute the auditor's burden more evenly over the year. After all, closing at the end of a season's activity is only permitting business to follow its natural course. If an accountant, after a study of the seasonal nature of his client's business, sincerely feels that there is much to be gained from the adoption of the natural business year, he is rendering his client a constructive and helpful service in recommending the change. On the other hand, considering the many benefits inherent in the natural business year accounting period, it should be evident that in failing to recommend its adoption to those of his clients who would benefit from the change, the accountant is neglecting their best interests. It therefore follows that public accountants should investigate the possible advantages of the adoption of the natural business year and recommend its acceptance whenever the best interests of their clients warrant.

## Personnel

### Spreads the Work

Just as the natural business year facilitates the taking and pricing of inventories, so also the books of account can be closed most conveniently and with less interference with ordinary routine duties at the close of the natural fiscal year. It is inevitable that the personnel of the accounting department should find themselves loaded down with the many additional details incident to the closing of the books for the past year. Generally speaking, the work of this department is greater at the end of the accounting period than at any other time during the year. Spreading this additional work into an otherwise low point in shipments, collections, and production, results in less confusion in the company's accounting department and the minimum of interruption of normal routine. What may be said in this respect of the accounting department may likewise be said in varying degrees of the planning and production departments, the sales department and other divisions of a business.

### Winter Vacations

Apart from the many advantages which accrue to the business itself from the acceptance of the natural business year principle, certain personal benefits are obtained by its officers and employees. Among these might be mentioned the fact that fiscal year closings have made winter vacations possible for many executives and employees. The extra work connected with closing the books around December 31st prevents many from availing themselves of this privilege.

### Disagreeable Weather

Another fiscal year benefit, of more interest to employees than

executives and thus affecting a larger number of individuals, is the avoidance of the necessity of taking inventories, particularly those outside, when the weather is most disagreeable and threatening to health. Practicing public accountants have observed many instances where very inaccurate inventory counts were attributable to the haste on the part of the employees to get in from the cold. It goes without saying that uncomfortable conditions are never conducive to the most efficient work.

### Holidays

Because it frees them during the double holiday period of Christmas and New Year's from the extra burdens of inventory taking and other year-end duties, most employees welcome a change from December 31st. It is only natural that they should like to spend as much time as possible at this season of the year with their families and friends. Many businesses spend considerable sums of money annually for the enjoyment and welfare of their workers, yet overlook this feature which is most important to many employees. The necessity for filing numerous federal and state social security tax returns and various other state forms about January 31st, when added to additional work required in getting the accounts ready for audit, makes December 31st in many cases the most inconvenient time of the year to close the corporate books.

### Stabilization of Employment

Widespread adoption of the natural business year would mean stabilization of employment and earnings for thousands of employees, a matter which now commands the time and energies of men in responsible executive positions. Transferring the extra work required in closing the books for the year to a period of normally low activity brings relief from unduly strenuous days and long hours of overtime often required during the early months of the year for those who close December 31st. It is the considered opinion of many that the adoption of the natural business year promotes regular employment and more stable earnings for employees, thereby helping to foster social security and improved employer-employee relations. Furthermore, for concerns located in states having merit-rating provisions in their unemployment insurance laws, stabilization of employment means better employment experience records and consequently lower unemployment insurance taxes. When considered over a period of years, this advantage and tax-saving alone should dictate the adoption of the natural business year as the accounting period of the enterprise. Moreover, as heretofore stated, valuing inventories when they are lowest presents maximum opportunities

to prevent overstatement of profits and the consequent overpayment of income, capital stock, and excess-profits taxes. It is submitted further that most business men will subscribe to the belief that an even continuity of work is the best assurance of efficiency.

## Federal Tax Advantages

Contrary to an apparently widespread belief, the government does not require businesses to file income tax returns on a calendar year basis.

Agitation for the natural business year dates back to 1909, when Congress, in utter disregard of business, passed a federal corporate tax law requiring all companies to file income tax returns on the basis of a twelve-months' period ended December 31st. By the time business men awakened to this new restriction it was too late. Businesses which for years had been closing their books in the dull season were forced to adopt a calendar year. When the hardships were realized, bankers, accountants, and credit men joined trade association executives and business men in vigorously protesting the new requirement. The result was that in 1913 this section of the law was repealed. Since that time each business has been free to choose its own natural business year as its fiscal year.

### Income Tax

Recent revenue laws have been enacted in the late spring or summer, although their provisions have, for the most part, been made retroactive to taxable years beginning after the preceding December 31st. The summary following shows the approval and effective dates of recent revenue acts.

| *Revenue Act* | *Date approved* | *Effective date: Taxable years beginning after** |
|---|---|---|
| 1934 | May 10, 1934 | December 31, 1933 |
| 1935 | August 30, 1935 | December 31, 1935 |
| 1936 | June 22, 1936 | December 31, 1935 |
| 1937 | August 26, 1937 | December 31, 1936 |
| 1938 | May 28, 1938 | December 31, 1937 |
| 1939 | June 29, 1939 | December 31, 1939 |

From the foregoing it will be observed that taxpayers whose fiscal years end between June 30 and November 30, inclusive, have a distinct advantage over calendar year taxpayers in that fiscal year businesses are not required to operate blindly under a revenue law which has not yet been enacted. Generally speaking, before entering into important transactions involving in many instances large sums of money, they know what tax liability will be incurred and can intelligently consummate each transaction in the most advantageous manner. On the other hand, calendar year taxpayers operate from four to eight months without definite knowledge as to the tax liabilities they are assuming.

As most taxpayers doubtless realize, tax rates are being increased constantly and certain exemptions

* The effective dates differ from those stated above in the case of certain special provisions of the respective acts.

are being reduced or eliminated. The taxpayer whose fiscal year ends late in the calendar year thus enjoys a distinct advantage in the postponement of increased tax rates.

Frequently calendar year corporations, after consummating transactions in the early part of the year in accordance with the revenue act then in effect, found that a new tax law, subsequently enacted, contained unforeseen provisions. For example, the change in the definition of "capital assets" in the Revenue Act of 1938 in certain instances worked substantial hardships on many taxpayers (other than corporations) who, in good faith, entered into what were considered capital gain transactions early in the year 1938 only to find that after the 1938 Act had been enacted, such gains were not considered capital gains. Accordingly, such gains could not be "scaled" down but were taxable in their entirety.

In the case of corporations, the retroactive limitation of capital losses to $2,000, first included in the Revenue Act of 1934, worked decided hardships upon hundreds of taxpayers closing their books on a calendar year basis. It is to be presumed that in many cases taxpayers would not have consummated transactions which resulted in capital losses had they realized that such losses would not be recognized for tax purposes. Unquestionably fiscal year corporations have the distinct advantage of eliminating, or at least reducing, the uncertainty of retroactive taxation. Furthermore, the additional time obtained in which to study the new law permits the arrangement of business affairs so as to minimize tax burdens, due to the clarification of new provisions of revenue acts before they become effective. Another point to be considered on the matter of taxes is that the majority of other federal and state tax returns are filed on the basis of the calendar year or calendar quarter and are due January or February of the year following, i. e., federal and state social security, franchise, and annual reports. For this reason the accounting departments of many corporations are overworked during the early months of the year in the preparation and filing of miscellaneous federal, state, and local tax returns and reports. For calendar year businesses these various reports must, of necessity, be prepared at a time when the accounting department is busily engaged in closing the books for the year. Manifestly, if the corporation is on a fiscal year basis, so that the books are closed and the income tax returns filed as of a date other than December 31, the work of the accounting department is spread more uniformly throughout the year.

## Capital Stock and Excess-Profits Taxes

Perhaps one of the most tangible benefits to be obtained from the

adoption of the natural business year is the saving in federal capital stock and excess-profits taxes. Under the revenue act now in effect a corporation on a calendar year basis is required to estimate its taxable income for the last five or six months of each year in order to determine the value to declare for capital stock tax purposes on the return filed on July 31 of each year. With respect to these particular taxes, experience has shown that most corporations overpay their taxes by:

(1) "Playing safe" and declaring a high capital stock valuation, thus paying an excessive capital stock tax, or

(2) "Taking a chance" and declaring too low a valuation for their capital stock, thus subjecting themselves to a substantial excess-profits tax.

Whichever procedure is followed, it is obvious that the calendar year corporation pays an extra tax which in effect is a penalty for a bad guess. On the other hand, if a corporation has a fiscal year ending with July 31 or August 31, it must estimate its taxable income for only one or two months of the year, i. e., from June 30 to the close of its taxable year. Accordingly, the total capital stock and excess-profits tax can be held to a minimum. This particular tax saving is, of course, not applicable to fiscal years ending on January 31 to June 30, inclusive.

There is perhaps another intangible advantage to the adoption of the natural business year which merits consideration and that is that accountants are more familiar with a new tax law when it comes time to file many fiscal year returns, and are thus in a position to take advantage of every possible tax saving for their clients. Quite often rulings interpreting new provisions of the law are issued before fiscal year returns are due. Further, it should be remembered that during the past few years, the regulations have been promulgated too late, generally speaking, to be of help in the preparation of calendar year returns.

### Social Security Taxes

Attention has previously been called to the fact that stabilization of employment and regularity of work result in lower unemployment insurance taxes for taxpayers operating in states having merit-rating provisions in their unemployment insurance laws.

### Effect Upon the Treasury Department

Another significant fact is that if more businesses would spread their year end closings, federal tax receipts of the Treasury would come in more uniformly throughout the year, the huge jam in the Collector's office around March 15 would be somewhat relieved, and the seasonal refinancing problem of the Treasury, arising on tax payment dates, would be moderated.

It is generally known that one reason for the very large number

of requests for extensions of time for filing income tax returns, with the consequent additional expenditure of time, is the fact that many accountants are not able to complete their annual audits and prepare the federal tax returns in time for filing by March 15. Quite generally in recent years, the Treasury Department has been loath to grant extensions of time within which to file federal income tax returns, especially to taxpayers who fall into the category of "habitual extensioners." Only bona fide reasons, such as deaths, serious illness and the like, are recognized. There is every reason to believe that it will become increasingly difficult for taxpayers to obtain frequent extensions in the filing of their tax returns in future years.

The Treasury Department has cooperated with the Natural Business Year Council by supplying information upon the number of taxpayers who have changed from calendar to fiscal year closings. The numbers are significant and impressive. It is reported by the Commissioner of Internal Revenue that during the past five years some 14,000 corporations have changed from the calendar year to the natural fiscal year basis of accounting. The idea is gaining momentum, and advocates of the natural business year, with its many advantages of efficiency and economy, are rapidly increasing in number.

The Bureau of Internal Revenue is swamped around March 15 each year with income tax returns and is, therefore, quite willing to permit a taxpayer to change its accounting period to one ending at the close of its natural business year in order that the work of filing and examining returns may be spread more uniformly over the year. The procedure to be followed in changing from a calendar to a natural business year basis of reporting is simple and quickly put into effect.

## General

Observations indicate that the attitude of business toward the natural business year is today more enlightened and favorable than ever before. The immediate and practical advantages accruing from its widespread adoption is causing the movement to gain considerable velocity. Today businesses are changing from calendar year to natural business year closings at the rate of almost two hundred and fifty per month. The time should not be far distant when all alert and progressive corporation executives will have carefully studied the possibilities of the change, with the inevitable result that the calendar year fetish will soon become as obsolete as the horse and buggy or the kerosene lamp.

The Natural Business Year Council has done a splendid piece of work in the compilation of data bearing upon the subject and the lively interest being shown in the

results of the Council's findings is indisputable testimony of the great service it is rendering American business.

In cooperation with the Natural Business Year Council, the research and statistical division of Dun & Bradstreet, Inc., has also been engaged for some time in an impartial fact-finding study of particular lines of business with a view to determining seasonal fluctuations and the natural fiscal year closing date of each. The results of these studies are available to the public through the medium of a series of informational bulletins released periodically by Dun & Bradstreet, Inc.

Experience has shown that some business men are still laboring under the mistaken impression that the advantages of the natural business year apply only to manufacturing corporations or businesses having large inventories. Of course, this is not so. Small corporations benefit relatively as much as large corporations and the advantages apply to non-profit organizations as well as those organized for profit. During the past several years many corporations, the nature of whose business was such as to require little or no inventory, have found the benefits of the natural business year to be of sufficient importance to warrant a change from the calendar year. In this connection it has been observed that many office buildings have leases which expire at a date like May 31 or September 30. Naturally, the logical time to close their books would be on one of those dates. New corporations particularly should explore the possibilities of its adoption.

A careful study of the factors surrounding the natural business year makes it clear that its advantages far outweigh any possible disadvantages. Astute business minds are realizing the possibility of adopting fiscal years which best suit their particular operation, so that a period covering twelve months' operation, and the report thereon, will end where it logically should end, that is, when activities have reached the lowest point in their annual cycle and when the period covered reflects a completed cycle of operations. Unmistakably, the present trend is away from calendar year closing.

In the interests of economy and efficiency, the natural business year of an enterprise should be adopted as its fiscal year.

# The Montgomery Library-Museum*

Now that I have seen the Montgomery Library-Museum at Coconut Grove, Florida, with its exhibits, display photographs and initial collection of books on tropical horticulture and related subjects, I appreciate its importance to the future of the Fairchild Tropical Garden even more than when Colonel Montgomery first outlined his plans for such a building. Not only will it contribute to the stability and permanence of the Garden project, and to its further development, but it will add greatly to the interest and usefulness of the Garden to those who may visit it, whether they be merely travelers who are interested in visiting a botanical garden of a kind hardly to be found elsewhere in the United States—because of climatic limitations, if for no other reason—or whether they be research students in tropical horticulture.

To the average person palms are primarily a symbol of the charm of tropical verdure. However, an inspection of the exhibits already in place—and these are but a beginning—brings home to one in a striking way the place, far beyond mere ornament, that the palm tree in its many different varieties has in the life of the peoples among whom it grows. The elemental needs of food, shelter, clothing and fuel are all among the useful purposes served by various species of palms, as is effectively portrayed by the exhibits of objects collected from both the Orient and the Occident and by the fine collection of photographs which adorn the walls of the building.

A striking illustration is the date palm which is described as the most valuable plant of all the Arab civilization of the old world. Without it a vast area of desert would be uninhabitable. Its fruit, its leaves and its timber are all used. The nipa palm is another species which is probably one of the most useful of the palms. Matting is made from its leaves and sugar and alcohol are made from its sap.

The coconut palm has long been known as a source of food which is not only used in the tropics but also transported to the temperate zones. What would a custard pie be without its coating of coconut! And this goes for many other achievements of the baker's and confectioner's arts.

The "gingerbread palms" of Africa, which, unlike most palms, have branching trunks, produce fruits which are eaten by the natives. Even the royal palm, of which one thinks as primarily a stately tree of superb

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*Supplement to an article in the March, 1940 issue of the L. R. B. & M. JOURNAL.

ornamental value in a landscape, produces a very tender terminal bud which makes a delicious salad. I make this statement "on information and belief," as I have no opportunity to sample such a salad. However, I did see in the museum cases specimen cans of the hearts of palm, also known as *coeur de palmier* or *palmita ideal,* which are packed for export. Sad to say, the palms are killed by taking their single buds, for they have only one on each tree.

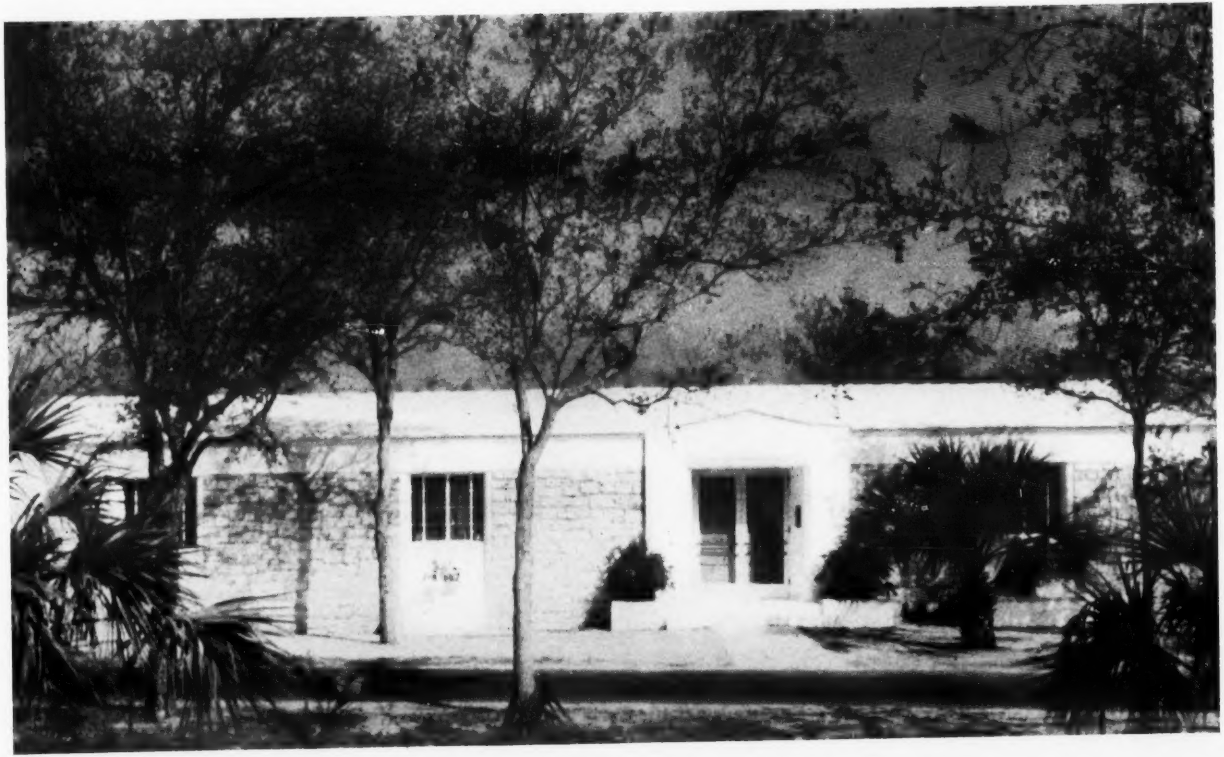
The palmyra palm is stated to have more than one hundred uses, among them being material for making baskets, rafters, thatch, well-sweeps, rope, matting, etc. The fruits are edible and, in addition, the nuts are germinated and the succulent "sinker" that the seed sends down into the ground is eaten raw or is cooked like asparagus.

The variety of useful articles produced for either wearing apparel or household use seems almost infinite. A few of them are cloth (plaited or woven, frequently in ornamental patterns), rain-coats made of palm fibre, hats of palm straw, buttons made from the ivory nut (hard fruits of the tagua or ivory nut palm), belts, purses and handbags, furniture of rattan, brooms, baskets, dishes (both plain and ornamental), spoons made from the coconut, and so on. Several of the tables for the use of visitors to the library were in themselves evidences of the usefulness of the palm tree, inasmuch as their bases or pedestals consisted of a section of the trunk of a royal palm. Another useful article is the wax obtained from the trunk of a certain species of palm.

An article which stirred my imagination was a winnowing basket. It was made of split palm and is used by primitive people all over the world. Grain, rice or millet is tossed in the air, the wind driving off the chaff. One could visualize the process which had been in use for thousands of years and then appraise the tremendous progress of our modern day with the invention of the reaper and thresher, and still later the harvesting and threshing machine known as the combine. Would one wish to abandon the use of these machines and return to the use of the winnowing basket? And yet we hear voices occasionally deploring the invention of labor-saving machinery!

The fine arts, too, are served by the palm family of trees. Among the exhibits in the museum is a landscape painted on a finely woven mat of rafia made in Madagascar. Another most interesting exhibit was a group of books made of slips of leaves of the palmyra palm, which had been inscribed by a stylus with characters in Pali, a script and language now used only by the priests in Ceylon. The inscription was made with a regularity and smoothness approaching that of copperplate engraving.

The religious life of the natives



THE MONTGOMERY LIBRARY-MUSEUM

of some of the home countries of the palm makes a call on the products of that remarkable tree. Votive offerings are made of objects of various kinds produced from the palm by clever handwork. In Mexico little figures are made of a man on horseback, which are called "Santiago" (Spanish for Saint James), and used in connection with local rites on the day of Saint James.

Even the "vices" of people in both tropical and temperate climates are served by the palm tree. The sap or juice of the toddy palm is used for making a drink which gives this palm its common name. The seeds or nuts of the betel palm are cut into pieces, a piece is then laid on a siri leaf of a certain vine, a few pinches of lime are added, and the whole is then rolled up and chewed. This causes the saliva to turn red and the teeth black. Cigarette papers are made from leaves of the nipa palm in Java. In Cuba many cigars are packed in the flower spathes of the royal palm instead of in boxes. These cigars are called *vegueros*.

The palm tree is also made to serve the destructive tendencies of humankind. Among the objects displayed in the museum are specimens of the instruments of war used by primitive peoples, such as spears, poisoned arrows, blowguns and darts, all products of the palm and devilish human ingenuity. Incidentally, when I think of our modern progress in making instruments of war more destructively efficient and more horrible in their application, I wonder how far we have really advanced from the "primitive" state of man!

One of the photographs which particularly aroused my interest was that of the double coconut (known botanically as *Laodicea Seychellarum*), the largest seed in the entire plant kingdom. It takes several years to germinate, five years to ripen, and the tree is forty years old before it bears its first fruit. The tree pictured in the photograph is the only fruiting tree in America and is in the botanic gardens at Georgetown, British Guiana. It will be of interest to Colonel Montgomery's friends to know that he has planted the nuts of quite a number of double coconuts on his place and that seven of them are growing. Here's hoping he will see them bearing fruit!

As I contemplated the picture of the double coconut tree, I was impressed with the patience with which nature works. We need to learn from her when we are inclined to be rash or premature in seeking to bring about change in long established customs. Yes, they may need improvement, and we shouldn't draw back from seeking to make change or improvement where needed, but patience and time—they are almost synonyms—are essentials to wise action.

And last of all, the appearance

of some of the home countries of the palm makes a call on the products of that remarkable tree. Votive offerings are made of objects of various kinds produced from the palm by clever handwork. In Mexico little figures are made of a man on horseback, which are called "Santiago" (Spanish for Saint James), and used in connection with local rites on the day of Saint James.

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of the building itself charmed me. Its style of architecture fits beautifully into its environment. Its interior, too, is well adapted to serve its double purpose of library and museum, and of affording opportunity for either browsing around among the exhibits or of using the books on the library shelves which constitute the George P. Brett collection and which will be added to as time goes on.

A more complete description of the building is not necessary at this time as the article in the March issue of the L. R. B. & M. JOURNAL gave the essentials thereof. A picture of the building is, however, presented in this issue of the JOURNAL so that it may be preserved in the L. R. B. & M. archives.

In concluding this rambling dissertation, I would mention for the information of the members of our New York staff that I saw in the grounds of Colonel Montgomery's home in Florida the sun-dial which they presented to him at the celebration last year of the fiftieth anniversary of his entrance into the accountancy profession. The sun-dial occupies a prominent and fitting position in the grounds, and continues to serve as a token of marking time by the rising and setting of the sun, as it had already done for two centuries or more in its previous location. (See page 83 of L. R. B. & M. JOURNAL for May, 1939.)

W. A. S.

# Treasury Regulations for "Last-in, First-out" Inventories

By Dallas Blair-Smith
*(New York Office)*

In 1939 taxpayers finally prevailed upon Congress to allow general use for income tax purposes of the "last-in, first-out" inventory method. The 1939 Act provision now appears in the Internal Revenue Code as Section 22(d), and was discussed in an article by A. R. Kassander (New York Office) which appeared in the L. R. B. & M. Journal for September, 1939. On December 28, 1939 the Treasury issued regulations for the administration of this last provision as T.D. 4959. They are now incorporated in Regulations 103 as Sec. 19.22(d).

## Requirements for Tax Use

The regulations state that any taxpayer permitted or required to take inventories for income tax purposes may now elect to use the "last-in, first-out" method, regardless of the nature of the business, and regardless of whether goods sold can be identified with specific purchases. The elective method must then be used with respect to goods specified in the taxpayer's application, but the Commissioner may require the method to be used with respect to other inventory goods also, if in his opinion the use of the method with respect to such other goods is essential to a clear reflection of income. Once the election is made, the taxpayer must adhere to the method in all subsequent taxable years, unless the use of another method is required by the Commissioner, or authorized by him pursuant to a written application filed by the taxpayer.

No taxpayer may change to the "last-in, first-out" method for tax purposes unless the statutory method has also been used since the beginning of the year of change in ascertaining income, profit, or loss, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, and such use for reporting purposes is continued in future years. If the taxpayer breaks this rule, the Commissioner may require him to change back to the inventory method formerly used for tax purposes.

## The Statutory Method

The "last-in, first-out" method allowed by the tax law is a method based on cost, without any adjustment for market prices which may be lower than such cost. However, the use in financial reports of mar-

ket value in lieu of cost will not preclude the use of the method for tax purposes.

The aggregate cost of goods under the elective method, to be used in the opening inventory of the first taxable year for which the method is used, is the cost of such inventory determined pursuant to the inventory method employed in the preceding year. The goods shall be considered as having been acquired at the same time, their unit costs being determined by the average cost method.

The specified goods remaining on hand at the close of the taxable year are treated as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

When the quantity of goods of the specified type in the closing inventory is larger than the quantity in the opening inventory, the Regulations require the excess to be included at costs determined as follows:

(a) By reference to the actual cost of the goods most recently purchased or produced;

(b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(c) By application of an average unit cost . . . of all of the goods purchased or produced throughout the taxable year . . . ; or

(d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

The method selected by the taxpayer for valuing the inventory increase must be adhered to so long as the elective inventory method is used. It will be observed that the costs of such increase may be determined on the basis of "last-in, first-out," "first-in, first-out" or average cost for the year. Examples of a simple application of these rules are given in the Regulations, as follows:

*Example 1:* Suppose that the taxpayer adopts the elective inventory method for the taxable year 1939 with an opening inventory of 10 units at 10 cents per unit, that it makes 1939 purchases of 10 units as follows:

| | | |
|---|---|---|
| January | 1 @ 11=11 | |
| April | 2 @ 12=24 | |
| July | 3 @ 13=39 | |
| October | 4 @ 14=56 | |
| | — | — |
| Totals: | 10 | 130 |

and that it has a 1939 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(*a*) Most recent purchases—

| | | |
|---|---|---|
| | 10 @ 10 | = 100 |
| | 4 @ 14 (October) | = 56 |
| | 1 @ 13 (July) | = 13 |
| | — | — |
| Totals: | 15 | 169 |

or

(*b*) In order of acquisition—

| | | |
|---|---|---|
| 10 @ 10 | | =100 |
| 1 @ 11 | (January) | = 11 |
| 2 @ 12 | (April) | = 24 |
| 2 @ 13 | (July) | = 26 |
| — | | — |
| Totals: 15 | | 161 |

or

(*c*) At an annual average—

| | | |
|---|---|---|
| 10 @ 10 | | =100 |
| 5 @ 13 | (130/10) | = 65 |
| — | | — |
| Totals: 15 | | 165 |

To cover the problem of determining cost for a subsequent closing inventory containing smaller quantities than the preceding inventory, the Regulations contain the following examples of the manner in which the prior inventory increase is to be reduced to quantities now to be valued:

*Example 2:* Suppose, in addition to the facts stated in example 1, that there is a 1940 closing inventory of 13 units. This closing inventory, being determined wholly by reference to the opening inventory, and being taken in the order of acquisition, and depending upon the taxpayer's method of valuing its inventory increase for the preceding taxable year, will be computed as follows:

(*a*) In case the increase was taken as most recent purchases—

| | | |
|---|---|---|
| 10 @ 10 | (from 1938) | =100 |
| 1 @ 13 | (July, 1939) | = 13 |
| 2 @ 14 | (October, 1939) | = 28 |
| — | | — |
| Totals: 13 | | 141 |

or

(*b*) In case the increase was taken in order of acquisition—

| | | |
|---|---|---|
| 10 @ 10 | (from 1938) | =100 |
| 1 @ 11 | (January, 1939) | = 11 |
| 2 @ 12 | (April, 1939) | = 24 |
| — | | — |
| Totals: 13 | | 135 |

or

(*c*) In case increase was taken on basis of an average—

| | | |
|---|---|---|
| 10 @ 10 | (from 1938) | =100 |
| 3 @ 10 | (from 1939) | = 39 |
| — | | — |
| Totals: 13 | | 139 |

Study of these examples reveals that the increase for the preceding year is reduced by eliminating the most recent purchases included in the increase. Thus, the items composing the increase, no matter which method was used in assigning cost thereto, are later eliminated on the "last-in, first-out" principle. If average cost was used in pricing the increase, that average is again used in pricing the portion of the increase eliminated.

It should be observed that the quantity of goods in the opening inventory of the year in which the elective method is adopted always carries with it to subsequent inventories the average cost of those goods. Such average cost is not affected by increases or decreases in subsequent inventories. However, if the quantity of goods in some subsequent inventory falls below the quantity in the initial opening inventory, then the original average

cost would, presumably, apply in the future only to the smaller quantity, and later increases in quantity would be valued according to the rules for determining the cost of inventory increases.

The simple examples given in the Regulations will undoubtedly prove helpful, but they constitute only a beginning of the solution of the many problems which will confront accountants in the application of the "last-in, first-out" inventory method to specific cases. The goods to which the method is to be applied may be specified by the taxpayer, subject to the Commissioner's right to require the use of the method for other goods in the inventory not specified by the taxpayer. It seems that the method may be applied to all inventory goods, or to certain raw materials alone (whether in raw material accounts, in goods in process, or in finished goods), and "last-in, first-out" costs may or may not include labor and overhead. The Regulations give no indication as to what types and combinations of types of goods or inventories, if specified by the taxpayer, are likely to meet with the Commissioner's approval. Such problems will no doubt have to be worked out by taxpayers and their accountants in conferences with the Treasury.

### Application to be Filed with Treasury

The Commissioner has ruled that the elective inventory method may be used only if the taxpayer files with his return, for the first taxable year for which the method is to be used, an application in triplicate on Form 970 (Revised January, 1940) containing a statement of his election to use such inventory method. The application must specify the goods to which the elective method is to be applied, and must be accompanied by certain detailed analyses of raw material, goods in process and finished goods inventories at the beginning and end of the taxable year and at the beginning of the preceding taxable year. It must also show in detail how costs are computed. The products (whether in process or finished goods) are to be segregated into natural groups clearly described. Other information as to the taxpayer's business or accounting system may be required by the Commissioner.

As to the Treasury's procedure with respect to such applications, the Regulations contain the following paragraph:

> Whether or not the taxpayer's application for the adoption and use of the elective inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method will be determined by the Commissioner in connection with the examination of the taxpayer's returns.

Accordingly, it seems that taxpayers who elect to use the method may not learn for several years whether or not the inventories stated

in the returns are acceptable to the Treasury. Final settlement of the question may, in some cases, entail inventory adjustments in the returns of several years, filed after the election was made. It is not clear whether a taxpayer would be bound by his election to use the inventory method with respect to certain goods if the Treasury should insist on applying it to additional goods in a manner unsatisfactory to the taxpayer.

### Adjustment of Prior Years' Income

In his application the taxpayer must agree in advance to "such adjustments incident to the change to the elective method, or to any later change from such method, in the inventories of prior taxable years or otherwise, as the Commissioner of Internal Revenue upon the examination of the taxpayer's returns for the years involved may deem necessary in order that the true income of the taxpayer will be clearly reflected. . . ." (Form 970, Revised).

This requirement appears to reflect a spirit of caution on the part of the Treasury. The law specifically provides that the specified goods in the closing inventory of the preceding taxable year shall be stated at cost, and would require additional tax to be paid for such preceding year, if any specified goods had been included in the closing inventory at market values lower than cost. That provision seems to cover the only adjustment incident to the change which could fairly be made for prior years; it seems to the writer that Congress intended the use of the new inventory method to begin with the year for which the taxpayer elects to use it.

### Effect of Purchase and Sales Contracts

In a business where sales contracts are habitually matched with purchase orders of raw materials, the taxpayer might naturally wish to state cost of goods sold so as to include the cost of the particular material purchased against the sales reported for the year.* The "last-in, first-out" inventory method will not necessarily accomplish this end, but apparently the Treasury plans to allow some such procedure. The regulations provide:

> If the elective inventory method is used by a taxpayer who regularly and consistently, in a manner similar to hedging on a futures market, matches purchases with sales, then firm purchase and sales contracts (i.e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the taxpayer and

*See "Inventories and Taxes," by Edward A. Kracke, *Journal of Accountancy* for December, 1939, page 373.

that, in the opinion of the Commissioner, income is clearly reflected thereby.

The foregoing paragraph may have been included in the Regulations to enable certain taxpayers in basic commodity industries to use for tax purposes certain procedures which some of them are now using for accounting purposes, such as the inclusion in sales of goods sold under firm contracts for future delivery. Another interpretation of the Regulation is that it may allow taxpayers to charge sales (completed shipments) with the cost of materials purchased against specific sales contracts, whether physically used or not for such sales.

### Who Should Adopt "Last-in, First-out"?

For accounting and reporting purposes, the "last-in, first-out" inventory method has in the past been used chiefly in those industries in which inventories of raw materials subject to wide price fluctuations are an important factor. The taxpayers in such industries are the ones who may be expected to adopt the method for income tax purposes. The method is not a mere tax-saving device, although its use might save taxes over a long period for a taxpayer whose present inventory method allocates income improperly among the years in such a manner as to indicate net losses in some years and net profits in others.

Even the avoidance of "loss years" is no longer so vital a tax motive as heretofore, for the current income tax law allows a two-year carry-over of "net operating losses." However, proper avoidance of net losses may still be advantageous, for there is precedent for depriving taxpayers of such a carry-over if deep depression comes again, and the government needs more taxes. In addition, the present carry-over is restricted, and a taxpayer may not be able to apply it in such a manner as to offset future income to the extent of all the net losses which may be shown under the "first-in, first-out" method in times of falling prices.

### Investigation before Adoption

The "last-in, first-out" inventory method is deemed to be beneficial to those types of business to which it is theoretically appropriate. No business concern, however, should adopt the method for purely theoretical reasons, but only after an exhaustive investigation has been made of the probable effects upon the stating of the net income of that particular concern. It is suggested that, wherever practicable, the inventories of a suitable number of past years should be restated on the approximate basis of "last-in, first-out," and the effects of such restatement on net income be carefully studied. In the light of that study the probable effects of the method upon future operations may be more confidently judged.

# The L. R. B. & M. Journal

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**The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest, and to help in the solution of common problems.**

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## Natural Business Year

The subject of the natural business year versus the traditional calendar year has been under particularly active discussion since the formation a few years ago of the Natural Business Year Council. This Council, which consists of representatives of such organizations as the Robert Morris Associates, National Association of Credit Men, American Management Association, American Trade Association Executives, Dun & Bradstreet, and others, has been active in bringing to the attention of business concerns the advantages of keeping their accounts on the basis of the natural business year.

At one of our offices, viz., Rockford, many clients have been much interested in the subject and have taken the necessary steps to change from December 31 to a fiscal year

best suited to the needs of their particular business and to the industry in which they are engaged.

It seemed to us that our various offices, as well as many of our clients, would be interested in the many aspects of the situation which have been developed in the leading article in this issue of the JOURNAL which was written by Mr. John W. Conrad, Manager of the Rockford office. It brings out very effectively how businesses may profit from adoption of the natural business year instead of adhering to the traditional calendar year if it is not best adapted to their use.

## A Quarter Century Anniversary

This month it is just twenty-five years since our Boston office was opened under the direction of Mr. Keller. Within a short time thereafter, Mr. Sweet joined the Boston forces. Through these years they have shared the responsibility of leadership of the office. In the course of time, Mr. Perry joined the staff and for over a decade has been a partner and has shared with Messrs. Sweet and Keller the responsibilities of directing the services rendered by the firm to its clients in the New England area.

The task of starting an office "from scratch" when, in the early days of the World War, it seemed that our firm should be in a position to render the best of service to its New England clients was no light one. It included the building up and training of a staff, the development of office organization and procedures as practice increased, the keeping of pace with the evolving thought of the profession in the last quarter century, the continued improvement of our practice technique, the recognition of added responsibilities due to the enactment of such legislation as the Securities Act, the Securities Exchange Act, and the Public Utility Holding Company Act, and the participation in the activities of professional bodies such as the Massachusetts Society of Certified Public Accountants, in which both partners and staff members have served as officers and committee members, and the American Institute of Accountants, in which important committee work has also been done. All this has meant the expenditure of much time and thought, and the carrying of a heavy burden through the years.

In addition to the effective contribution which the Boston office has made to the professional work of the firm and the service rendered to its clients, that office has made an outstanding contribution to the enjoyment of our work through the fine relations which have obtained between it and the other offices of the firm. This has been characteristic, not only of the relations between the members of the firm, but also between members of the Boston

staff and the staff at other offices as joint engagements or the annual meetings of the firm have brought them together.

The entire L. R. B. & M. organization extends to the Boston office its congratulations on a quarter century of splendid accomplishment and best wishes for the continuation of its fine record in the years ahead.

## Common Sense Taxation

One of the most annoying features of the Treasury's administration of the federal income tax laws has been the apparent effort to switch deductions claimed for such losses as bad debts or worthless securities from the year in which the taxpayer made the claim therefor in his tax return to some other year in which the deduction would do him no good, or at least be of less tax value because of his having either no taxable income in such other year or not enough to offset the loss claimed. This tendency has become more and more marked with the passing years and no one feature of the actions of revenue agents, reviewers, or conferees has done more to make taxpayers "sore." The experience of both the Treasury and tax practitioners has been that taxpayers, as a class, are honest, and when a loss is claimed to have occurred in a given year it may be assumed that there is at least *prima facie* ground for the claim.

Further, the development of uncollectibility of a receivable or the worthlessness of shares of stock is not infrequently so gradual, and dependent upon a number of different circumstances which do not necessarily occur simultaneously, that it is extremely difficult to say at just what moment uncollectibility or worthlessness has occurred. This fact has made it difficult for taxpayers who have been the victims of the Treasury practice above mentioned, particularly because the position taken by the Treasury is presumed to be correct in case of subsequent litigation and the taxpayer has the burden of proving that the Treasury is wrong.

In view of the foregoing, the recent decision of the United States Circuit Court of Appeals for the Second Circuit in *Herskovits v. Commissioner,* concerning the year in which a loss should be deductible by a partnership which had loaned money to an individual in Germany, is refreshing. The debtor became bankrupt in 1931 but in 1932 and 1933 promised to repay the debt. In 1934 he wrote that the situation was hopeless and the partnership deducted the loss in that year. The Board of Tax Appeals denied the deduction in 1934. The Circuit Court, in reversing the Board, said, "taxpayers should be given a reasonable amount of discretion in such matters when acting in good faith." It is to be hoped that the

(*Continued on page 32*)

# Notes

The latest annual report of the Director of Libraries of Columbia University states that outstanding additions to the Montgomery Library of Accounting are the account books of the Moscha family of Pisa, 1332-1645; of Effingham Lawrence, a colonial merchant; and of Julius Mallinckrodt, a Dutch dealer in chemicals.

The Montgomery Library of Accounting at Columbia contains so many items of historical interest to the accountant that every member of the L. R. B. & M. staff at New York, who has not yet seen the collection, is urged to visit the library.

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The April, 1940, issue of *The Accounting Forum,* a publication of the School of Commerce of the College of the City of New York, contained an article by Mr. Lenhart on "Some Accounting Problems Arising Out of the War."

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Mr. Staub was one of the speakers at a round-table session and dinner meeting of the National Industrial Conference Board at the Hotel Waldorf-Astoria on April 18. The general subject was "Problems of Taxation and Public Expenditure." Mr. Staub spoke on "The Taxation of Business Enterprise." Other speakers included Mr. Franklin Spencer Edmonds of Philadelphia, the Hon. Ogden J. Ross of the New York State Tax Commission, Mr. Fred A. Eldean, Executive Director of the Tax Foundation, and Dr. O. Glenn Saxon, Commissioner of the Connecticut Department of Finance and Control.

On May 10 Mr. Staub was one of three guests of honor at a luncheon meeting in Syracuse of the chapter in that city of the New York State Society of Certified Public Accountants. It was six years to the day from the granting of a charter to the chapter, which was one of three chapters organized while Mr. Staub was president of the New York State Society. During the six intervening years the Syracuse chapter has grown from twelve members to almost fifty.

In the evening Mr. Staub was one of three gentlemen who were made honorary members of the Syracuse University chapter of Beta Alpha Psi, the national accounting fraternity, which has chapters in most of the colleges and universities of the country where there are schools of business administration in which accounting courses are given. The conferring of the membership took place at a dinner of the chapter at the University Club in Syracuse.

On May 13 Mr. Staub addressed two of the classes in The Amos Tuck

School of Administration and Finance of Dartmouth College. The subject of his talk to the class on financial management was the work of the Securities and Exchange Commission under the Chandler Act (Chapter X of the Bankruptcy Act), and certain trends indicated by the advisory opinions which the Commission has thus far rendered. His talk to the accounting class related to the accounting requirements of the Securities and Exchange Commission. A discussion period followed each talk.

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Mr. Fischer, who is at this time president of the Pennsylvania Institute of Certified Public Accountants, was one of the speakers at the twenty-fifth anniversary meeting and the second accounting clinic held by the Indiana Association of Certified Public Accountants, with the cooperation of Butler University (on the campus of which the clinic was held) and the American Institute of Accountants in Indianapolis on May 10 and 11. Mr. Fischer contributed a paper to the Round Table Session on "Experiences With Extensions of Auditing Procedure."

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Mr. Russell read a paper on "Accounting Problems Arising From War Orders on United States Government Contracts" at a meeting of the Detroit Chapter of the National Association of Cost Accountants on May 2.

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Mr. Stephen B. Ives was one of the speakers on the program of the Southern States Accountants' Conference, which was held at the Jung Hotel in New Orleans, April 25-27. The State Societies cooperating were Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, Oklahoma, Tennessee and Texas. The general theme of the Conference was "Accounting in the Public Interest."

At the meeting of the Atlanta Chapter of the National Association of Cost Accountants, held on May 14, Mr. Ives spoke on the subject, "The Accountant's Responsibility Under Two Acts Administered by the S. E. C."

Mr. Ives has been appointed a member of the National Affairs Committee of the Atlanta Chamber of Commerce.

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Mr. Robert S. Warner is serving as Chairman of the Banquet Committee for the annual meeting of the National Association of Cost Accountants, which will be held in St. Louis in June. The N. A. C. A. Chapter of that city is going to great lengths to make the convention an inviting one for out-of-town members.

Among the featured attractions will be visits to the beautiful Ozark mountain regions of Missouri and

to St. Louis' famed Municipal Opera.

The banquet, which takes place on next to the last night of the convention, and the entertainment program that evening are being designed as a "break" in the more serious work of the convention. The program will be a stiff ordeal for those who wish to take advantage of all it will offer of a technical and timely character on the subject of cost accounting and its utilization for effective management.

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Mr. Mark E. Richardson of the Philadelphia office staff has been appointed General Chairman of the 1940 annual meeting which will be held by the Pennsylvania Institute of Certified Public Accountants at Skytop Lodge (Pa.) in June.

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Mr. Albert E. Hunter of the Boston staff, who is Vice-President of the Massachusetts Society of Certified Public Accountants, is Chairman of the New England Accounting Conference, which will be held in Boston on May 23 and 24.

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Mr. William D. Buge of the Chicago office delivered a talk on the subject of "Federal Income Taxes" before the Aurora Accountants Society, Aurora, Illinois.

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Members of the staff have passed the C. P. A. examinations in their respective states, as follows:

*Boston:*
W. A. Monroe
K. B. Murray
J. F. Sanborn, Jr.
F. G. Shaw

*Cleveland:*
E. H. Anzalone
G. A. Jenkins

*New York:*
J. E. Bierschenk
J. G. Campbell
J. G. Gaisser
Sewell Keeter
J. A. Marik
H. G. Phipps
C. R. Rauth
G. H. Schneider
H. A. S. Van Daalen, Jr.
W. G. Wilkins

*Philadelphia:*
Paul Dohan
John Maisch
Philip Taylor

*San Francisco:*
H. B. Lane
W. G. Moore
W. M. Towers

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Mr. John J. Cordner, of our New York staff (as is also one of his sons), has the pleasure of knowing that his youngest son, William F., now in his senior year at Amherst College, has been the recipient of special honor for his accomplishments during his college course. A letter from Mr. Charles A. Andrews, Amherst, '95, and treasurer of the college, to Mr. Bell, also an

alumnus, described an unusual incident at College Chapel, and epitomizes the remarks of Professor Jordan of the Department of Physical Education, who is also the football coach, as follows:

Four years ago a boy came to Amherst determined first of all if he could do it to reach his father's expectations as to his own academic record. He had also an interest in intercollegiate athletics. Now his four years are almost completed. He has attained the academic record which he and his father hoped for and he has acquired the esteem of all the teachers with whom he has been associated. He is a boy of the highest character. I have looked back through the Amherst College records and I find that in the present era of modern college athletics he is the only boy at Amherst who has earned and received his A in four major sports—baseball, track, basketball, and football. Last fall he was captain of football. He was captain of a ship which was going down. That's where to a remarkable degree he displayed his character. And then this winter he was on the basketball squad under another captain, giving to that activity one hundred per cent of his ability and loyalty just the same as he has always done here at Amherst towards any enterprise, athletic or academic, with which he has been connected.

We don't want Bill Cordner to go away from Amherst without a knowledge of the respect and esteem which we all have for him and a token of it, too. Come forward, please, Bill, and accept from us this blanket in the colors of the College with four stars on it indicating the four major A's you have earned. Take it as a mark of the esteem which all of us, undergraduates and faculty alike, have for you.

The April, 1940, issue of *American Speech,* a quarterly of linguistic usage which is published by Columbia University Press, contained an article by Mr. Robert J. Fitzpatrick, of our Louisville staff, entitled, "Language of the Tobacco Market."

The Contributors' Column of the magazine referred to Mr. Fitzpatrick and his article in the following language:

Although Robert J. Fitzpatrick is an accountant in Louisville, Kentucky, his interest in linguistics has led him to the study of slang and argots of various sorts. His article in this issue is the result of his experience in the tobacco business.

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Mr. H. C. Hawes of the Chicago office is a member of the Committee on Investigation and Complaints of the Illinois Society of Certified Public Accountants, and Mr. Carl W. Lutz is a member of the Committee on Legislation of the same Society. Mr. Hawes has also served for several years as member of the School Board of Deerfield Grammar School, Deerfield, Illinois, and is a member of the Auditing Committee of the Chicago Association of Commerce.

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Mr. Hal S. Wilson has been admitted to membership and Mr. F. M. Hilliard has been admitted to associate membership in the American Institute of Accountants. Both are members of the staff at our Chicago office.

Mr. James Harold Kirby and Mr. Ralph J. Young of the New York staff have been admitted to membership in the New York Society of Certified Public Accountants, and Mr. Harry G. Phipps to associate membership. Mr. Harold John Olson has been advanced from associate membership to membership in the Society.

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An article in the *New York Times Magazine* of April 21, which was sent by wireless from Moscow by the Russian correspondent of that paper, had as its subject, Mr. Laurence A. Steinhardt, present United States Ambassador to Russia. It is of interest to note from the article that after Mr. Steinhardt had finished his work at Columbia University in 1916, he joined the New York office of Messrs. Deloitte, Plender, Griffiths & Co., public accountants of high standing, and served there before entering the United States Army during the World War.

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A recent issue of *Newsweek* indicated that the alphabetical method of designating organizations was in use for at least two centuries before the New Deal came into being. *Newsweek* states that CFIHCOR-FLBFBACWTCOLAWATLTA-TPTA was the designation for the Contributors for Insuring Houses, Chambers or Rooms From Loss by Fire by Amicable Contribution Within the Cities of London and Westminster and the Liberties Thereof and the Places Thereunto Adjoining.

That organization was founded on November 12, 1696, at Tom's Coffee House in London.

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## Common Sense Taxation

(*Continued from page 27*)

Treasury will see the desirability of adopting this view of the Court and will recognize that in equity taxpayers are entitled to a tax benefit from losses sustained, and that losses should not be transferred from one year to another merely because the taxpayer secured a tax benefit in the year in which he claimed the deduction.

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